

Revenue Review

Tennessee Department of Revenue

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Tennessee's Sales Tax Holiday: What Retailers Need to Know

Tennessee is among 11 other states and the District of Columbia that have enacted sales tax holidays. These states include: Connecticut (2001); Florida (1998); Georgia (2002); Iowa (2000); Massachusetts (2004); Missouri (2004); New Mexico (2005); New York (1997); North Carolina (2001); South Carolina (2000); and Texas (1999). The District of Columbia enacted its holiday in 2004.

A sales tax holiday seeks to provide relief to taxpayers by instituting a temporary sales tax exemption on certain items for a specific period of time.

When is the sales tax holiday? Tennessee's annual sales tax holiday begins in **August 2006**. The holiday starts each year at 12:01 a.m. on the first Friday in August and ends at 11:59 p.m. on the following Sunday. Thus, for 2006, the holiday will start at 12:01 a.m. on August 4 and end at 11:59 p.m. on August 6.

What items qualify for the sales tax holiday? During the holiday, the following items are exempt from sales and use tax: 1) clothing with a price of \$100 or less per item; 2) school supplies with a price of \$100 or less per item; and 3) computers with a price of \$1,500 or less per item.

What items of clothing qualify? Clothing is defined as human wearing apparel suitable for general use. This includes shirts, dresses, pants, coats, gloves and mittens, hats and caps, hosiery, neckties, belts, sneakers, shoes, uniforms whether athletic or non-athletic, and scarves. Clothing DOES NOT include belt buckles sold separately, patches and emblems sold separately, sewing equipment and supplies or sewing materials that become part of "clothing" such as thread, fabric, yarns and zippers.

While clothing is eligible for the holiday, clothing accessories, protective equipment and sport or recreational equipment are NOT eligible for the holiday and are subject to tax during the holiday period. Clothing accessories include briefcases, cosmetics, hair notions, handbags, jewelry, wallets, umbrellas, sunglasses and watches. Protective equipment includes breathing masks, hard hats, face shields, helmets, paint or dust respirators, hearing protectors, safety glasses and goggles, tool belts, protective gloves, and welders' gloves. Sports or recreational equipment includes ballet and tap shoes, cleated or spiked athletic shoes, gloves such as baseball, boxing and golf, goggles, hand and elbow guards, life preservers and vests, mouth guards, roller and ice skates, shin guards, shoulder

pads, ski boots, and wetsuits and fins.

What types of items qualify as school supplies?

A school supply is defined as an item used by a student in a course of study. The definition contains an all-inclusive list of school supplies. Examples are binders, book bags, calculators, tape, chalk, crayons, erasers, folders, glue, pens, pencils, lunch boxes, notebooks, paper, rulers, and scissors.

Excluded from the holiday (and therefore subject to sales tax) are school art supplies consisting of clay and glazes, paints, paintbrushes for artwork, sketch and drawing pads and watercolors, school instructional material and school computer supplies consisting of computer storage media, diskettes, compact disks, handheld electronic schedulers, personal digital assistants, computer printers, and printer supplies for computers, including printer paper and printer ink.

Do school textbooks or workbooks qualify for the holiday? School textbooks and workbooks are exempt from sales tax. They do not qualify for the holiday because they fall within the school instructional material exception. However, because they are already exempt from tax, no holiday is necessary on these items.

A textbook is defined as a printed book that contains systematically organized educational information that covers the primary objectives of a course of study. A textbook may contain stories and excerpts of popular fiction and nonfiction writings, but does not include a book primarily published and distributed for sale to the general public. A workbook means a printed booklet that contains problems and exercises in which a student may directly write answers or responses to the problems and exercises. Neither the term textbook nor workbook include a computer or computer software.

Does computer software qualify for the holiday?

No. While computers with a price of \$1,500 or less may be purchased exempt from tax during the holiday, purchases of computer software are excluded from the holiday and are subject to tax.

Does the \$100 exemption apply to the first \$100 of a school supply or an item of clothing being purchased? In other words, if the selling price of a book or a clothing item is \$105, is the first \$100 exempt from sales tax? No. The exemption applies to items selling for \$100 or less. If an item sells for more than \$100 (\$105 in this example), tax is due on the entire selling price.

What if I buy a pair of shoes for \$125, could I split the pair of shoes to fall below the threshold? No. A retailer MAY NOT split items that are normally sold together in order to fall under the sales price threshold.

Will items purchased for my business be eligible for the tax exemption during the sales tax holiday? No. The exemption does not apply to items used in a trade or business or to items that are rented. If you make a purchase for an item that is to be used in a trade or business and the retailer does not collect sales tax from you, you are obligated to report this purchase and pay use tax on the item. You may report and pay this on your regularly filed return, or if you do not have a sales tax account, you may report and pay this on a consumer use tax return available on the department's Web site.

Additional guidance on how to handle layaways, returns, exchanges, coupons and discounts is available on the department's Web site.

Frequently Asked Sales/Use Tax Questions

Q: Can a commercial dry cleaner qualify for Tennessee manufacturing exemptions?

No. The Tennessee law provides certain exemptions from sales and use tax to manufacturers. Industrial machinery is exempt from sales and use tax, and utilities used by manufacturers are subject to tax at reduced rates (T.C.A. Section 67-6-206). To qualify for these exemptions, a taxpayer must be principally engaged in the fabrication or processing of tangible personal property for resale. Dry-cleaning and laundry services do not constitute "fabricating or processing tangible personal property for resale." The purpose of laundry and dry-cleaning services is to restore an item to its original state, not to change it into a new state or form. Additionally, cleaning services are addressed by Tenn. Code Ann. Section 67-6-102(25)(F), which clearly states that the laundering or dry-cleaning of any kind of tangible personal property constitutes a taxable service. Thus, a commercial dry cleaner cannot qualify for Tennessee manufacturing exemptions.

Q: Are computer consulting services subject to sales/use tax?

In many instances, yes. Consulting services alone are not taxable. However, such services are frequently sold in conjunction with the transfer of software and taxable services. Software is currently taxed as tangible personal property (T.C.A. Section 67-6-102(30)(B)). The "sales price" of software and other tangible personal property includes *the total amount for which it is sold, including any services that are a part of the sale* (T.C.A. Section 67-6-102(26)). Thus, any charges for services that are performed as part of the sale of software are subject to tax. For example, in *Creasy Systems Consultants, Inc. v. Olsen*, 716 S.W.2d 35 (Tenn. 1986), the Tennessee Supreme Court held that hourly consulting charges for determining the needs of a client, designing a software program to meet those needs, and then writing the software program were all subject to sales tax. Thus, if consulting services are not provided as additional services separate and optional from the sale of software or taxable services, they are subject to tax in Tennessee.

Q: Should a Tennessee software developer collect Tennessee sales tax on software it installs on a server located in Tennessee if the customer buying the software is located outside Tennessee and only accesses the software via the Internet?

Yes. The software is located on a server in Tennessee and is used by the out-of-state customer on a server in Tennessee. Thus, title and/or possession of the software have transferred to the customer in Tennessee. This is a taxable sale of software, and the developer should collect Tennessee sales tax on the transaction.

Q: When must an aircraft dealer charge sales tax on his proceeds? And when may this dealer purchase an aircraft exempt from sales/use tax?

If an aircraft dealer leases the aircraft without an operator or crew, then the dealer is leasing tangible personal property. The dealer should collect sales tax from his customers on the lease payments, provided that his customer is not otherwise exempt under Tennessee sales and use tax statutes. Under these circumstances, the dealer may purchase the aircraft on a properly executed Certificate of Resale.

If an aircraft dealer purchases an aircraft and uses it to provide flight training, then the dealer is rendering a non-taxable service and should not collect sales tax from his customers. The dealer also is exempt from paying sales/use tax on his purchase of the aircraft or other property that will be used in providing the training (T.C.A. Section 67-6-204(b)).

If an aircraft dealer purchases an aircraft and leases it with an operator or crew, then the dealer is rendering a non-taxable service and should not collect sales tax from his customers. However, the dealer would owe sales and use tax on his purchase price of the plane and any repairs and repair/replacement parts, provided that the dealer is not otherwise statutorily exempt from paying sales and use tax on his purchase.

If the aircraft dealer uses the plane for both taxable and non-taxable activities, then the primary use of the plane determines the taxability at the time of purchase.

Threshold Lowered for Mandatory Sales and Use Tax Electronic Filing

Public Chapter 131, Acts of 2005 lowers the threshold for mandatory electronic filing of sales tax returns and electronic payment of the tax due to apply to any taxpayer whose average monthly tax liability is **\$5,000 or more**. Tenn. Code Ann. Section 67-1-703(b) requires taxpayers whose average monthly liability is \$10,000 or more to make payments in readily available funds. In 2002, it became mandatory to file sales and use tax returns electronically if a taxpayer was required to pay its sales and use tax in readily available funds. Electronic filing of these returns has reduced errors and lowered processing costs. Under this public chapter, the requirement to file sales and use tax returns electronically and pay in readily available funds applies to any taxpayer whose average monthly tax liability is \$5,000 or more. It also gives the commissioner authority to waive these electronic payment and filing requirements in extenuating circumstances.

The Department of Revenue will notify taxpayers whose average monthly liability falls on or above the \$5,000 threshold when mandatory electronic filing for the lower threshold becomes effective. However, the department encourages those taxpayers whose average monthly liability equals or exceeds \$5,000 to register for and begin filing electronically now.

Individual (Hall) Income Tax

Most Tennesseans know that Tennessee does not impose a tax on general income from sources such as wages, salaries, and Social Security and pension income. However, Tennessee does have a form of income tax. Enacted in 1932, the Hall income tax (named after the legislative sponsor) is one of the oldest taxes in Tennessee. It is a 6% levy and generally applies annually to income from investments such as stocks and bonds, but not to basic savings accounts, CDs, and employer-sponsored retirement accounts.

The tax applies to individuals, partnerships, associations, and trusts that are legally domiciled in Tennessee. A person legally domiciled in another state but maintaining a place of residence in Tennessee for more than six months of the year is also subject to the tax. This does not apply to military personnel and full-time students who are legally domiciled in another state. The income a person receives while legally domiciled in Tennessee is subject to the tax.

The first \$1,250 of taxable income is exempt (\$2,500 on a joint return). Individuals 65 years old or older with total annual income of \$16,200 or less (\$27,000 for joint filers) are exempt from this tax. Blind persons may be exempt upon filing a statement from their eye specialist. Only those people whose legal domicile is in Tennessee and whose taxable interest and/or dividend income exceed \$1,250 (\$2,500 for joint filers) are required to file.

The Department of Revenue offers an electronic filing option for individual income tax filers through an Internet application available on the department's Web site at www.tennesseeanytime.org/etax/. Revenue encourages individual income taxpayers to utilize the e-filing option. E-filing is easy, fast, and the most reliable and secure method of filing tax returns. With return and payment information being posted to the department's system electronically, there is no worry about returns lost in the mail, human error in data entry, or missed filing deadlines. And e-filing is available 24 hours a day, seven days a week, so taxpayers may always file at their own convenience.

Taxpayers also may file paper returns. If the taxpayer is on a calendar-year basis, either the electronic or paper return should be filed (postmarked) no later than April 15 (or the first workday thereafter if April 15 is a weekend or holiday). For a taxpayer on a fiscal year filing, the return is due by the 15th day of the fourth month following the end of the fiscal year. Paper returns should be mailed to Tennessee Department of Revenue, Andrew Jackson Building, 500 Deaderick St., Nashville, TN 37242. Provisions for filing applications for extensions and for making estimated payments are available through the e-file option. More information can be found on the department's Web site, www.Tennessee.gov/revenue, by selecting the link for "Individual Income Tax."

Save the Date: Upcoming Seminars and New Business Workshops Across the State

Visit our Web site, www.Tennessee.gov/revenue, and click on "Seminars, New Business Workshops and Speakers" to learn more about upcoming seminars and workshops.

Frequently Asked Franchise/Excise Tax Questions

Q: When should you deduct construction in progress on Schedule G, determination of real and tangible property?

Construction in progress is not included in the minimum tax base if the property is not being used by the taxpayer in whole or in part. If a company is expanding and building additional facilities, this property is not included until it is used by the taxpayer. However, if a company builds houses for others, the property must be included in Schedule G. In that case, the company shows this property on its balance sheet as inventory, and the property is being used by the company.

Q: Who can take the deduction for qualified charitable deductions, and what is required to qualify for the deduction?

Taxpayers that donate to nonprofit organizations that are exempt from federal tax under sections 501(c)(3), (4), (5), or (6) of the Internal Revenue Code can deduct 75% of the amount donated when computing their excise tax base. The donations must be monetary. The exempt organization must certify to the taxpayer that the donation was spent to purchase goods or services subject to Tennessee sales and use tax and that the sales and use tax was actually paid. The nonprofit entity must provide to the taxpayer a certification form once the donation is spent. This certification form is available at www.state.tn.us/revenue/forms/fae/excisededuction.pdf. This will be used to determine the available deduction.

Q: When can the franchise tax be prorated?

Proration of the franchise tax will be allowed only in two instances:

1. If the tax year closes within less than 12 months since incorporation, domestication, or commencement of doing business in Tennessee, or
2. If the taxpayer changes its accounting period covered by the federal return.

No other proration of franchise tax will be allowed.

Q: If a taxpayer elects to calculate its net worth on a consolidated basis, which members of the affiliated group are subject to franchise and excise tax?

Only the entities that are doing business in Tennessee or exercising the corporate franchise are subject to the franchise and excise tax. The election to compute net worth on a consolidated basis does not affect the entity's nexus in the state. Only the method of calculating the franchise tax is different for that entity and the other taxpayers in the group with nexus in the state. Taxpayers who are subject to the franchise tax before electing to calculate their net worth on a consolidated basis are still required to file their own franchise and excise tax returns.

Q: What should be included on Lines 2 and 13 on Schedule J for the depreciation?

Line 2 is an add-back of only the amount of federal depreciation that has been taken on assets using the bonus method of depreciation provided for in IRC Section 168. Line 13 is a deduction of the state basis depreciation on assets under the bonus method. The depreciation represented on these lines should only be depreciation involved with assets under the federal bonus method.

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Online Business Tax Registration

You can do the following online:

- Register a business
- Add a new location to an existing business in Tennessee
- Change the business address(es)
- Close a business account

These online registration activities can be done for the following taxes:

- Franchise and Excise Taxes
- Sales and Use Tax
- Television and Telecommunications Tax
- Motor Vehicle Surcharge
- Tire Fee
- Used Motor Oil

Tax Liens

When any person is liable to pay any state tax or fee administered by the Tennessee Department of Revenue (TDR) or neglects or refuses to pay the tax or fee, the amount of the tax or fee shall be a lien in favor of the state. The lien arises at the time an initial assessment of liability is made and remains until that assessment and any subsequent assessments are paid in full. The tax lien attaches to all interest in property, real or personal, tangible or intangible in Tennessee, owned or subsequently acquired by the person against whom the assessment is made. The notice of lien is recorded with the register of deeds in the county or counties where the taxpayer's business or residence is located or where the taxpayer has interests in property.

TDR's Tax Enforcement Division is responsible for collecting delinquent taxes and therefore usually files tax liens. When Tax Enforcement receives a collection case on a delinquent taxpayer, a written demand for payment is mailed or delivered to the taxpayer. Then personal contact is made. If these attempts fail, notice of tax lien may be filed.

Contact Us

- Taxpayer hot line: Statewide toll-free (800) 342-1003; Nashville-area and out-of-state callers should call (615) 253-0600.
- Online tax help by e-mailing TN.Revenue@state.tn.us.
- Streamlined Sales Tax hot line: In Tennessee, call (877) 250-2299. In Nashville and outside Tennessee, call (615) 253-0752.
- Streamlined Sales Tax online assistance by e-mailing Streamlined.Salestax.QandA@state.tn.us.
- Tax practitioner hot line: Statewide toll-free (800) 387-8395; Nashville-area and out-of-state callers should call (615) 253-0700.
- Local government hot line: (866) 562-2549.
- E-mail updates: Visit our Web site, www.Tennessee.gov/revenue, to subscribe to Revenue-News or lists dedicated to county clerks and city officials.
- Electronic commerce hot line: Statewide toll-free: (866) 368-6374. Nashville-area and out-of-state callers should dial (615) 253-0704.
- Tax fraud hot line: To report tax fraud, call (800) FRAUDTX (372-8389).

Tax liens are filed in one of two ways:

1. If a taxpayer fails to respond to a collection notice, the revenue officer requests a lien be filed **or**
2. A lien will be filed when the taxpayer enters into an agreement to pay delinquent taxes on a payment plan or it is determined that the taxpayer's liability is uncollectible.

A notice of lien is mailed to the register of deeds for recordation, and a copy of the recorded notice is returned to the department for entry into TDR's computer system. Liens remain until the taxpayer's account is in a current status or the statute of limitations for collection has expired.

To obtain release of a lien, the taxpayer must pay all outstanding tax liabilities, and his/her account must be in a current status. The taxpayer can determine his/her outstanding liabilities by contacting the Special Procedures Unit of the Tax Enforcement Division by calling (615) 741-7074 or writing the Tax Enforcement Division at P.O. Box 190665, Nashville, TN 37219-0665.

We Want Your Feedback

We work each day to serve our customers. Your feedback on our customer service and our Web site helps us provide outstanding service and meaningful, useful information on the Internet. To let us know how we're doing and how we can better meet your needs, visit our Web site, www.Tennessee.gov/revenue, and click on "We want to hear from you!" Separate surveys related to our service and our Web site are available for online completion.

Online Sales Tax Filing Statistics

Month	Number of Returns	Total of Amount Collected
August 2005	13,238	\$148,150,278
September 2005	13,331	\$148,376,687
October 2005	14,515	\$154,150,178

Are you a registered taxpayer? If YES, we need your tax contact's e-mail address, so we can e-mail information in the future. Call toll-free (800) 342-1003; Nashville-area and out-of-state callers, dial (615) 253-0600.



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